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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941

No. 673

EARLE F. WINGREN, Trustee in Bankruptcy of The Mutual Investment and Security Company, Bankrupt,
Petitioner and Appellee Below,

vs.

MINNIE C. HANSSEN, THYRA H. MANKIN BERGER, W. J. O'NEILL, J. F. McGRAW, CATHERINE J. HANNA, P. B. McATEE, MAY WALSHE, FRANCES E. JOHNSTON, E. F. MITCHELL, KATE A. MITCHELL, MARGARET SWINK, LAURA E. PARKER and ALBERT J. GOULD,
Respondents and Appellants Below.

REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT.

STATEMENT OF THE CASE

Compliance with Rules of Court

Respondents would make it appear, by means of misleading numerical statistics compiled by them from petitioner's petition and brief, that petitioner has violated Rule 38 (2) of this court. Compliance with that rule as

to the contents of the petition, and with Rule 27 as to the form and substance of the brief, necessitates some repetition in the brief of matter stated in the petition. The fact is, the sixteen propositions stated in the petition (Pet. pp. 10-14) are specified as eight points (Br. pp. 22-24), and the argument thereof covered in twenty-seven pages (Br. pp. 26-52). Of the total sixty-four pages, ten constitute the appendix of statutes required by Rule 27 (f). The complexity of the problems involved, and the necessity of repeated reference to the many sections of the bankruptcy act which are applicable, permit no less.

Facts

It is submitted that respondents' brief is, in fact, no answer at all, either in opposition to the issuance of the desired writ, or in refutation of the propositions of law stated. It contains principally simple denials of some of the arguments of petitioner, no attempt at analysis or discussion of the authorities cited, and the citation of only two cases, both of which have been clearly distinguished in petitioner's brief from the case now before the court.

Both by direct statement and inference, respondents have implied that each of them had claimed augmentation (their brief, pp. 2, 10, 12, 14), citing one of the documents (R. 120) excluded from the record by the District Judge (R. 69-71) wherein it appears that *two* of the creditors had claimed augmentation. The position of these two creditors is not typical of all creditors mentioned in Section VIII, nor indeed even typical of all of respondents (See R. 159, 214-16).

Respondents have repeatedly used the words "voluntary backers" in referring to the creditors included in Section IX of the plan (See pages 3, 4, 7, 9, 14, 15, Res. Br.). The use of such words is intended to discredit the position of Section IX creditors and place upon them responsibility for respondents' situation (See pp. 3, 9, 14, 15, Res. Br.) which is not rightfully theirs. Cited as support for such statement is an explanation of the facts

appearing in petitioner's brief below (R. 155) which actually disposes effectively of any such contention (See also Pet. Br. p. 34).

On pages six and eleven of respondents' brief the statement is made that the class IX creditors appeared by counsel in this matter, the inference being that all the Class IX creditors voluntarily appeared; this is untrue (See R. 65, 70, 71, 128-9, and especially 154-5, wherein the status of the claims of creditors represented by amici curiae is correctly described). The voluntary appearance of some of the general creditors in this controversy does not amount to the appearance of all, and where the issues are not properly formed, does not justify the entry of an order determining the ultimate rights of all the creditors. *Davis* v *Louisville Trust Co.*, 181 Fed. 10 (6th C.C.A. 1910).

At the bottom of page six of their brief, respondents make the astounding statement that petitioner does not pretend that the decision of the Circuit Court of Appeals was unjust. Petitioner vehemently denies that there is any equity or justice in it, "in any moral sense" or otherwise. The summary statement preliminary to the petition for the writ calls attention to the inequitable result of the decision (Pet. p. 1), the point is raised in Question numbered 4 (Pet. p. 11), specified as error in points numbered 1 and 3 (Pet. p. 22), and argued in Section I, subparagraph (d) (Pet. pp. 31-32). It was also argued in the brief in support of petition for rehearing (R. 210-214).

ARGUMENT

1. *Pepper* v. *Litton* has been improperly applied.
2. No equitable estoppel has been shown.
3. Petitioner entitled to argue all questions which the court refused to determine below, in connection with application for writ on the grounds stated in "Reasons" numbered one to seven inclusive.

4. Decision of Circuit Court conflicts with *Rude* v. *Buchhalter* on the procedural question.

5. Respondents have shown no cause why the writ applied for should be denied.

1. Respondents state (their brief p. 8) that the Circuit Court used "its clear equitable and statutory powers" to subordinate one group of claimants on the equitable considerations existing between the claimants themselves, and that no priority has been created, but they have failed to answer the argument denying the power of the Circuit Court, *either* to subordinate or grant a priority in this case (Pet. Br. pp. 26-37), and have cited no contrary authorities. They have ignored *In re Columbia Ribbon Company*, infra, which is precisely in point, where the question arose under an adjudication under Section 236, Chapter X, in proceedings initiated under Section 77 B, exactly as here. The Court said:

> "As we have seen, Section 238 directs that the proceeding be conducted 'so far as possible, in the same manner and with like effect' as if the petition for reorganization had been an ordinary involuntary bankruptcy petition and the approval of the petition an adjudication of bankruptcy. It follows that the court in determining the priority of claims against the estate is bound by the provisions of Section 64, sub. a, as amended, 11 U. S. C. A. Sec. 104, sub. a, which specify the classes of debts which are to have priority of payment over general creditors of a bankrupt estate and the order of their payment with respect to each other. Five classes of debts having priority are established. The first class includes 'the costs and expenses of administration.' Since Congress has set up no order of priority within the first class the court may not fix priorities within the class. Missouri v. Ross, 299 U. S. 72, 57 S. Ct. 60, 81 L. Ed. 46; Missouri v. Earhart, 8 Cir., 111 F. (2d) 992, certiorari denied 61 S. Ct. 43, 85 L. Ed. . . .

"The referee and the court below grounded their action in granting priorities within the class of administration expenses upon what they believed to be the equitable powers of a court of bankruptcy. It is well settled, as the Circuit Court of Appeals for the Fourth Circuit pointed out in Westall v. Avery, 171 F. 626, 628, 'that bankruptcy proceedings themselves are purely equitable in their character, and, within the limits prescribed by the Bankruptcy Act (11 U. S. C. A. Sec. 1 et seq.) and the special rules of practice prescribed by the Supreme Court, are to be administered in accord with the general principles and practices of equity.' See Local Loan Co. v. Hunt, 292 U. S. 234, 54 S. Ct. 695, 78 L. Ed. 1230, 93 A. L. R. 195. But these equitable powers are to be exercised within the limits laid down by the Bankruptcy Act and subject to its specific provisions. In re Concentrated Products Corp., 3 Cir., 38 F. 2d 745. The court may not by granting a priority which it deems equitable set aside the clear congressional mandate that no such priority shall be accorded. Pepper v. Litton, 308 U. S. 295, 60 S. Ct. 238, 84 L. Ed. 281, which was relied on by the referee and court below, is not to the contrary. That case holds that a court of bankruptcy under its equitable powers may disallow or subordinate a particular claim in bankruptcy, which because of the fraudulent nature of the claim or the bad faith or improper conduct of the claimant, ought not in equity and good conscience to be allowed or paid on a parity with other claims. It does not hold that the court may set up a subclassification of claims within a class given equal priority by the Bankruptcy Act and fix an order of priority for the sub-classes according to its theory of equity. . . .

In re Columbia Ribbon Co., 117 F. (2d) 999, 1001, 1002.

That *Pepper v. Litton* presented a different question appears from Mr. Justice Douglas' own statement at the beginning of the opinion:

> "The case presents the question of the power of the bankruptcy court to disallow either as a secured or as a general or unsecured claim a judgment obtained by the dominant and controlling stockholder of the bankrupt corporation on alleged salary claims."

Subordination of the claim of a creditor because of his own fraudulent conduct, where the creditor is before the court and the issues are properly framed, is quite a different thing from subordination of the claims of an entire class of creditors who are not before the court, and where no issues bearing on the equitable considerations existing between the claimants themselves have been presented. *Pepper* v. *Litton* certainly is not authority for the proposition that a Circuit Court has the power to inquire into the validity of one claim, and on that inquiry subordinate claims not before it on the appeal. *Pepper* v. *Litton* is merely an application of the principle of clean hands; the record here contains no facts calling for such application.

It clearly follows that the Circuit Court decided this case in a way not in accord with applicable decisions of this court and in conflict with principles established by this court.

2. Respondents state at page nine of their brief that petitioner "intimates, or states, on several occasions that a bankruptcy creditor can lawfully be subordinated 'only for moral turpitude'." There is no such statement in petitioner's brief.

Petitioner devoted considerable space to an analysis of *Bird and Son Sales Corp.* v. *Tobin*, 76 Fed. (2nd) 371, 100 A. L. R. 654 (Br. pp. 33-4) for the express purpose of pointing out that notice was given to all creditors

before decision by the court. Respondents have ignored this important feature, and merely cite the case to show that creditors *can* voluntarily subordinate themselves by acts and omissions which, under equitable principles, estop them—a general statement which is undoubtedly true, but which has no application to this case.

3. Since petitioner does not know, and cannot conclude from the opinion, on what "equitable considerations" the Circuit Court subordinated the Section IX creditors, he has argued each ground on which the Circuit Court might have based such subordination. The necessity of so doing sufficiently answers any charge of inconsistency in the argument of petitioner, and there can be no question of petitioner's right to argue such points, as well as all those questions which the Circuit Court expressly refused to determine, in connection with his application for writ on the grounds stated in "Reasons" numbered one to seven (Pet. pp. 14-17).

Respondents now claim that questions involving the Chandler Act are moot. They were argued at length in all the briefs below, and are the proper subject of argument by petitioner in this case where the application for the writ is based squarely on the refusal of the court to apply the plain mandate of the bankruptcy act. For example, the application of Section 238, Chapter X, is one of the vital points of the controversy. Cf. *In re Columbia Ribbon Company*, infra, pp. 4-5.

4. Apparently respondents' view is that the questions relating to the power of the Circuit Court to render the decision handed down may not now be raised, since not argued below. These questions never arose until the decision was rendered—no issues were formed nor evidence introduced either calling for or permitting a decision by the Circuit Court on the basis adopted; they were first presented to the court in Petition for Rehearing which is the earliest they could have been raised on the record as made (R. 207-18).

This is not the first time the Circuit Court of the Tenth Circuit has erroneously attempted to exercise equitable powers and has gone beyond the issues presented by the record. In *Buchhalter* v. *Rude*, 54 Fed. (2nd) 834, the court imposed certain conditions in the decree which "appeared" to the court "to be equitable" (p. 839). Certiorari was granted, and the decision modified in *Rude* v. *Buchhalter*, 286 U. S. 451, 76 L. Ed. 1221. The court said:

> "The Circuit Court of Appeals went beyond the issues presented by the record. Its opinion shows that determination of the appeals did not require findings as to the good faith of petitioner. . . . And petitioner had no reason to apprehend that any such matter would be considered on either appeal. He had no opportunity to be heard in respect of the authority of the court to make such an allowance or as to the facts touching the propriety of basis of the same. Petition for rehearing and denial, as here, upon a reasoned opinion may not in such a matter fairly be regarded as the equivalent of a hearing in advance of decision." (286 U. S. 460, 76 L. Ed. 1225.)

How much less, then, can it be said that the Section IX creditors have had a hearing in advance of decision in this case, where, after petition for rehearing filed, no additional opinion was filed.

Questions relating to the validity of respondents lien were properly raised in the circuit court; the court, on the issues before it, should have decided whether they did or did not have a lien; it refused so to decide, but went beyond the issues and rendered a decision on questions not before it. Respondents have never attempted to form issues before any court on the question of the existence or non-existence of such equities; in their reply brief in the Circuit Court they insisted (R. 187-190) that they claimed a lien, not a preference or priority.

On the record, the decision was plainly in conflict with the principles established by *Rude* v. *Buchhalter, supra.*

5. Respondents have failed to demonstrate any reason for the refusal of this court to grant the writ applied for.

It is noteworthy that in conclusion of their brief (pp. 13-15) they deny categorically that any of the reasons stated by petition for the granting of the writ exist, and allege that there is no question of bankruptcy which has not already been settled by this court, and that the decision is amply sustained by the decisions cited therein; yet no cases are mentioned wherein the questions raised by this record have been decided adversely to petitioner.

It is noteworthy that respondents allege that the decision of the Tenth Circuit conflicts with that of no other circuit court, and yet no attempt is made to reconcile the decision of this court with the two cited by petitioner as being in conflict, i. e., *In re Columbia Ribbon Co.*, 117 Fed. (2nd) 999 (3d Cir. 1941), and *In re Carden*, 118 Fed. (2) 677 (2d Cir. 1941) (Pet. Br. pp. 15-16, 29, 31, 48). Since the filing of that brief, another case has been noted wherein the Eighth Circuit expressly approved the conclusions of *In re Columbia Ribbon Co., supra;* it is *U. S.* v. *Killoren*, 119 Fed. (2d) 364, wherein are also cited many other cases on this point mentioned in our first brief.

On October 20, 1941, there was published a new decision of the Second Circuit which is directly in point on the question of subordination on equitable considerations. Therein the court said:

> ". . . . Similarly, Bankruptcy Act, Sec. 65, sub. a, 11 U.S. C. A. Sec. 105, sub. a, requires, in liquidation, the distribution of 'dividends of an equal percentum' 'on all allowed claims, except such as have priority or are secured.' Moore v.

Bay, 284 U. S. 4, 52 S. Ct. 3, 76 L. Ed. 133, 76 A. L. R. 1198; Globe Bank & Tr. Co. v. Martin, 236 U. S. 288, 305, 35 S. Ct. 377, 59 L. Ed. 583; Sampsell v. Imperial Paper & Color Corp., 61 S. Ct. 904, 907, 85 L. Ed. ——. The only departures made from the ordinary rule of equality are based on some very definite equity, such as fraud, Pepper v. Litton, 308 U. S. 295, 60 S. Ct. 238, 84 L. Ed. 281, mismanagement of the debtor by a parent corporation, Taylor v. Standard Gas & Elec. Co., 306 U.S. 307, 59 S. Ct. 543, 83 L. Ed. 669, or concealment of a claim to the prejudice of another creditor, In re Bowman Hardware & Electric Co. 7 Cir., 67 F. 2d 792. In the absence of such an equity, subordination is not a function of the bankruptcy court. Crowder v. Allen-West Commission Co., 8 Cir., 213 F. 177, 184; Sampsell v. Imperial Paper & Color Corp., supra; cf. Moise v. Scheibel, 8 Cir., 245 Fed. 546." *Geist* v. *Prudence Realization Corp.* 122 Fed. 2d) Adv. Op. No. 4, p. 503, 505-6.

CONCLUSION

It is submitted that the purpose of the Circuit Court should have been to declare and enforce the bankruptcy law on the questions raised before it on appeal, not to punish the Section IX creditors (cf. *So. Pac.* v. *Bogart*, 250 U. S. 483, 63 L. Ed. 1099, 1109), nor to authorize the unjust enrichment of the Section VIII creditors at the expense of Section IX creditors who are not before the court and have never had an opportunity to be heard. Such is the effect of the decision of the Circuit Court. It constitutes such a radical departure from the accepted course of judicial determination as alone to demand (without regard to the many other valid reasons for granting the writ) the exercise of the powers of supervision of this court.

Respondents have presented no valid reason for the denial of the writ; they have cited no authorities authoriz-

ing its refusal; we respectfully submit that this cause should be reviewed and determined, and upon final hearing, the judgment of the Circuit Court of the Tenth Circuit reversed.

Denver, Colorado, October 31, 1941.

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